

11 U.S.C. § 549(a)
11 U.S.C. § 1107
11 U.S.C. § 1108
11 U.S.C. § 1123
28 U.S.C. § 158(A)
O.R.S. 72.5010(1)(b)
O.R.S. 72.5020
O.R.S. 72.7110(2)
O.R.S. 72.7160
U.C.C. § 2-502
Avoidance of transfer,
 ordinary course of
 business
Special property interest,
 identification of
 property
Deposit by buyer
 pre-petition
Sale of goods
 post-petition

Michael A. Grassmuck, Inc. v. Richard E. Caddock, Jr.,
 Civ. No. 93-6157
Michael A. Grassmuck, Inc. v. Richard E. Caddock, Sr.,
 Civ. No. 93-6156

11/3/93 Dist.Ct. (Judge Hogan) remanded to AER Unpublished

Bankruptcy trustee appealed decision of Bankruptcy court denying avoidance of transfer of drift boats in a Chapter 11 proceeding. Trustee argued that debtor was not authorized to sell the boats by giving defendants credit for the pre-petition deposits paid on the boats. Further, the trustee argued that allowing the credit for the pre-petition deposits against the purchase price treated the buyers preferentially over other pre-petition creditors. Defendants argued that under state law they had rights in the boats ahead of secured and unsecured creditors.

District court remanded the cases to the Bankruptcy court to consider: (1) Whether there was evidence of insolvency within 10 days of initial deposit; (2) Whether unsecured buyers have rights superior to a debtor-in-possession or unsecured supplier; (3) Whether the "special property" interest of the buyers has lapsed; (4) Whether buyers with "special property" interests have any other UCC remedies against the seller and ahead of other unsecured creditors; (5) Whether there is any evidence of value of pre-petition manufacturing as opposed to post-petition manufacturing; and (6) Whether there are other remedies available to defendants outside the UCC.

FILED
JUL 14 1993
U.S. DISTRICT COURT
J. V. B.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

MICHAEL A. GRASSMUECK, INC.,
Trustee,
Plaintiff,
v.
RICHARD E. CADDOCK, JR.,
Defendant.
Civil No. 93-6157 ✓

MICHAEL A. GRASSMUECK, INC.,
Trustee,
Plaintiff,
v.
RICHARD E. CADDOCK, SR.,
Defendant.
Civil No. 93-6156
ORDER

This is a bankruptcy appeal brought by a trustee pursuant to 28 U.S.C. §158(A). Plaintiff is the trustee of the bankruptcy case of Joel and Paula Shephard (debtors). The debtors operated a drift boat manufacturing business. On

(22)

approximately March 26, 1990, they entered into a contract with defendant Richard Caddock, Sr. to custom build a Kenai Guide boat. On that date, Mr. Caddock, Sr. paid debtors a deposit of \$11,040 to begin manufacturing the boat. On approximately February 11, 1990, the debtors contracted with defendant Richard Caddock, Jr. to custom build a different Kenai Guide boat. Mr. Caddock, Jr. paid debtors a deposit of \$1,000 on February 11, 1990, and \$10,040 on February 25, 1990. The debtors began manufacturing the two boats before filing a Chapter 11 bankruptcy proceeding on June 11, 1990. The boats were completed during the Chapter 11 proceeding and debtors transferred the boats to defendants after defendant Richard Caddock, Sr. paid an additional \$7,662.58, and defendant Richard Caddock, Jr. paid an additional \$7,912.38. Debtors credited the pre-petition deposits of \$11,040 against the purchase prices. There was no court order authorizing the transfers of the two boats during the Chapter 11 proceeding.

The Chapter 11 proceeding was thereafter converted to a Chapter 7 liquidation. Plaintiff then filed two adversary proceedings, one against Mr. Caddock, Sr. and one against Mr. Caddock, Jr. (defendants). The trustee sought to avoid the transfers pursuant to 11 U.S.C. §549, and a judgment from the defendants for the amounts of their pre-petition deposits, \$11,040 with certain setoffs for administrative expense claims. The adversary actions were tried to Judge Radcliffe based on a

pretrial order stipulating to pertinent facts and trial memoranda. Judge Radcliffe orally ruled in favor of defendants, dismissed the adversary proceedings with prejudice, and judgment was entered.

The trustee argues that even though debtors were authorized, in the Chapter 11 proceeding, to manufacture drift boats, they were not authorized to sell the boats by giving credit for the pre-petition debts (the \$11,040 deposits) owed to the purchasers. The trustee further argues that by allowing defendants to credit the pre-petition debts against the purchase prices, they were treated preferentially over other pre-petition creditors in the same class. Defendants argue they had rights in the boats ahead of unsecured and secured creditors of the debtors under state law, and honoring those rights does not unfairly treat unsecured creditors who are differently situated.

DISCUSSION

11 U.S.C. §549(a) provides that a trustee may avoid a transfer of property of the estate that occurs after the commencement of the case and that is not authorized under bankruptcy law or court order. Defendants argue that the sale of the boats was authorized by bankruptcy law. Section 1108 authorizes the trustee in a Chapter 11 to operate the debtors business. Section 1107 gives the debtor in possession that same power. Payment for goods sold after filing a Chapter 11 proceeding would ordinarily be considered to be made in the

ordinary course of business and not avoidable. See In Re U.S. Machine Tools, 38 B.R. 984, 987 (D. Conn. 1983). However, a trustee is authorized by Section 549 to retrieve monies belonging to the estate that were transferred following the filing of a Chapter 11 petition on account of prepetition debt. Lee Way Holding v. Action Industries, Inc., 113 B.R. 410, 412 (B. Ct. Ohio 1990); In Re U.S. Machine Tools, 38 B.R. 984, 987 (D. Conn. 1983); see also American Gypsum Co. v. Grover Trucking Co., 36 B.R. 360, 363 (B. Ct. N. M. 1984).

A chapter 11 plan must "provide the same treatment for each claim or interest of a particular class." 11 U.S.C. §1123. Prepetition creditors are to be paid under a plan, proposed to and accepted by creditors and confirmed by the bankruptcy court, unless there is a reason to grant them a status resulting in payment of a greater portion of their debt than to other unsecured prepetition creditors. In Re Isis Foods, Inc. 37 B.R. 334, 338 (D. Ct. Miss. 1984). Defendants argue that at the time the debtors filed the chapter 11 proceeding, they (defendants) had acquired rights in the boats ahead of unsecured and secured creditors of the debtors, and were entitled to possession of the boats by state law.

A buyer obtains a "special property interest" in future goods when those goods are "shipped, marked or otherwise designated by the seller as goods to which the contract refers." ORS 72.5010(1)(b). Judge Radcliffe ruled that "when the boats

in essence were manufactured, they were necessarily identified to the contract as being for a specific buyer." (Transcript of Proceedings, #8 at 5). He further explained that under ORS 72.5010(1)(b), the defendants acquired a property interest in the boats when the deposits were made and the manufacturing commenced. (Id.) Plaintiff argues that manufacturing a product to meet particular specifications is not enough to constitute identification and that there must be some specific writing that ties the product to the particular buyer. See Big Knob Volunteer Fire Co. v. Lowe & Moyer Garage, Inc., 487 A.2d 953 (Pa. 1985) (fire truck was identified by seller painting the buyer's name on the cab); Carey Aviation v. Giles World Marketing, Inc., 46 B.R. 458, 462 (D. Mass. 1985) (court relied on evidence of a writing identifying an I.D. number on the product as belonging to the buyer). In both Big Knob, and Carey Aviation there were written identifications. However, I do not interpret either of those cases as requiring a writing to meet the "marked or otherwise designated by the seller" requirement of ORS 72.5010.

In the case of "special order" goods which are not in existence at the time of contracting, identification does not occur until the goods come into existence. At least one court has held that the time of identification for goods to be manufactured to the buyer's specifications is the moment when the first step of production is made. Little v. Grizzly Mfg.,

636 P.2d 839 (Mont. 1981). Other courts have suggested that the issue is whether the work-in-progress is sufficient so that the good can adequately be identified to the contract. See, In Re Intern. Horizons, Inc., 21 B.R. 414, 416 at n. 6 (D.C. 1982); see also Carey Aviation, Inc. v. Giles World Marketing, 46 B.R. 458 (D. Mass. 1985) (specific model of aircraft two-thirds complete could be identified, because there was no requirement that the goods be in a deliverable state or that all of the seller's duties with respect to the goods be completed in order for identification of occur).

Plaintiff argues that any boats that met the specifications of defendants' orders would have fulfilled the contract, and therefore, the manufacturing of the particular boats did not create identification, citing Bende & Sons, Inc. v. Crown Recreation, Inc., 548 F.Supp. 1018 (E.D.N.Y. 1982). In Bende & Sons, Inc., supra, plaintiff contracted to sell 11,000 pairs of combat boots to the government of Ghana to be manufactured by a supplier chosen by plaintiff. The New York court held that the boot manufacturing was not identified to the contract, because the contract could have been fulfilled by any 11,000 Korean made boots. The court reasoned that nothing in the contract designated the particular manufacturer of the goods, and that because there were no specific markings on either the boots or on the containers used to transport the goods, any combat boots would have fit the general description outlined in the purchase

orders.

Bende is distinguishable from the facts in this case. The debtors were designated as the manufacturers. The defendants specially ordered features for the Kenai Guide boats, all customers ordered some modifications to standard hulls or to the interiors, no two boats were alike, and the boats built for the two defendants were among the most highly customized boats ever built by the debtors. (Pretrial Order, #10). In addition, prior to the filing, the debtors had manufactured the aluminum hulls according to the specifications of defendants and had drilled into the boats' hulls to allow for fastening the specially ordered motor wells. The boats provided were so specialized and were identified and designated to the sales contracts prior to the filing under either a "first step in production" or "work-in-progress" test.

A most difficult issue in this action is whether defendant purchasers maintained any "special property rights" to the identified boats ahead of any sellers' or unsecured creditors' rights at the time the sellers filed bankruptcy. Plaintiff argues that even if defendants had "special property rights," those rights ceased when the debtors did not become insolvent within ten days of the initial payments by defendants. ORS 72.5020 states that a buyer may recover goods from an insolvent seller if: (1) The buyer has a special property interest in the goods, and (2) The buyer paid part or all of the purchase price

(plaintiff concedes this element is proved), and (3) The buyer must keep good a tender of any unpaid portion of the purchase price, and (4) The seller must become insolvent within ten days after receipt of the first installment of the purchase price. In this action, it is undisputed that defendant Richard E. Caddock, Sr. made an initial payment of \$11,040.00 on March 26, 1990, and that defendant Richard E. Caddock, Jr. made an initial payment of \$1,000 on February 11, 1990. (Pretrial Order, #10). It is also undisputed that the debtors filed a Chapter 11 petition on June 11, 1990. There is no evidence in the record to suggest that the debtors became insolvent within ten days of the initial payments by defendants.

Defendants argue that their acquisition of the custom manufactured boats gave them certain other rights against the debtors: under ORS 72.7110(2) the buyer has the right to recover the goods as provided in ORS 72.5020, to obtain specific performance or to replevy the goods as provided in ORS 72.7160. It is noteworthy that the only remedy expressly made available to a buyer in a case of an insolvent seller, and accorded priority over remedies of other unsecured creditors, is the right to recover goods under ORS 72.5020. The issue is what affect the filing of bankruptcy has on the buyer's other general remedies (ORS 72.7110 through 72.7160). The official comment to Section 2-502 of the Uniform Commercial Code (ORS 72.5020) states, in part:

The question of whether the buyer also acquires a security interest in identified goods and has rights to the goods when insolvency takes place after the ten-day period provided in this section depends upon compliance with the provisions of the Article on Secured Transactions (Article Nine).
See also In re Tennecomp Systems, Inc., 12 B.R. 729, 737 (B. Ct. Tenn. 1981).

There is no evidence that defendants were secured creditors. Stated differently, assuming a supplier furnished goods on an unsecured basis to a debtor seller, that those goods were "identified" to a contract, should the unsecured buyer have rights in goods superior to the rights of a debtor-in-possession or the unsecured supplier? If the only remedies available to defendants under the UCC at the time of filing the Chapter 11 proceeding are those also available to unsecured creditors, then hasn't any "special property" interest that may have existed lapsed?

Judge Radcliffe relied on Carey Aviation, Inc. v. Giles World Marketing, Inc. (Transcript, #8). The court notes that in Carey Aviation, Inc. v. Giles World Marketing, Inc., 46 B.R. 458 (D. Mass. 1985), the result was that a buyer with a "special property" interest had a right to recover property in possession of a secured party who had filed a Chapter 11 petition. However, the court reasoned that the buyer had standing to sue the secured creditor on the basis of a "special property" right, only if the secured party's action in seizing the goods resulted in "actionable injury" and only if the buyer qualified as a buyer in the ordinary course at the time of that seizure, citing


sections of Article Nine. In other words, the buyer's right to recover under a "special property" theory was subordinate, unless that buyer also met the "buyer in the ordinary course" requirements of Article Nine. Id. 46 B.R. at 462. The court in Carey ordered that the secured party turn over the goods to the buyer, because the buyer had met the definition of "a buyer in the ordinary course" at the time of the seizure. In this action, neither of the parties have raised Article Nine issues. In addition, Carey appears to support the proposition that ability to assert rights based on a "special property" interest under the UCC is dependent upon there also being some corresponding special remedy which has priority over other unsecured or secured parties' remedies.

This action is remanded to the bankruptcy court for further consideration of: (1) whether there is any other evidence of insolvency within ten days of the initial deposits, (2) the two questions of page 9 of this opinion, (3) whether there are any other UCC remedies available to a party with a "special property" interest against a seller and ahead of other unsecured creditors, (4) whether there is any evidence of the value of the prepetition manufacturing as opposed to the postpetition manufacturing, and (5) whether there are any other remedies available to defendants outside the Uniform Commercial Code, i.e., constructive trust, estoppel based on accepting benefits of an executory contract.

CONCLUSION

This action is remanded to the bankruptcy judge for further proceedings. This appeal is dismissed.

DATED this 3rd day of November, 1993.


UNITED STATES DISTRICT JUDGE

Entered 11-9-93

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

MICHAEL A. GRASSMUECK, INC.,

Plaintiff,

v.

Civil No. 93-6156-HO

RICHARD E. CADDOCK, SR.,

Defendant.

JUDGMENT

This action is remanded to the Bankruptcy Judge for further proceedings. This appeal is dismissed.

Dated: November 5, 1993.

Donald M. Cinnamond, Clerk

by *Lea Force*
Lea Force, Deputy

JUDGMENT

DOCUMENT NO: _____